IN THE COURT OF APPEALS OF TENNESSEE
AT NASHVILLE
July 10, 2003 Session

AMERICAN CORRECTIONS TRANSPORT, INC.
v.
RUTH E. JOHNSON, COMMISSIONER OF REVENUE, STATE OF TENNESSEE

An Appeal from the Chancery Court for Davidson County
No. 98-3639-I Irvin H. Kilcrease, Jr., Chancellor

No. M2002-01509-COA-R3-CV - Filed November 25, 2003

This is a claim for a refund of Tennessee franchise and excise taxes. From 1987 through 1998, the taxpayer corporation was the sole owner of stock in a subsidiary corporation. In the taxpayer's 1996 Tennessee franchise and excise tax return, the taxpayer claimed a deduction based on its assertion that the stock in the subsidiary became worthless or was abandoned in 1996, and that its basis in that stock for state tax purposes was greater than its basis for federal tax purposes. The defendant Tennessee Commissioner of Revenue disallowed the deduction and sent the taxpayer a notice of assessment. The taxpayer paid the assessment, then filed the instant lawsuit for a refund. After a bench trial, the trial court rejected the taxpayer's claim and denied the refund. The taxpayer appeals. We affirm, finding that the taxpayer submitted insufficient evidence that there was an "other disposition" of its stock in 1996 to entitle it to deduction under T.C.A. § 67-4-805(b)(2)(D). In the alternative, we affirm the trial court's conclusion that the taxpayer did not submit sufficient evidence of the difference in its basis for state tax purposes and its basis for federal tax purposes so as to justify the claimed deduction under T.C.A. § 67-4-805(b)(2)(D).

Tenn. R. App. P. 3 Appeal as of Right; Judgment of the Chancery Court is Affirmed

HOLLY M. KIRBY, J., delivered the opinion of the court, in which DAVID R. FARMER, J., and WILLIAM H. INMAN, Sr. J., joined.

W. Gary Blackburn and Malcolm L. McCune, Nashville, Tennessee, for the appellant, American Corrections Transport, Inc.

Paul G. Summers, Attorney General & Reporter, Michael E. Moore, Solicitor General, and Wyla M. Posey, Assistant Attorney General, Nashville, Tennessee, for the appellee, Ruth E. Johnson, Commissioner of Revenue, State of Tennessee.

OPINION

Plaintiff/Appellant American Corrections Transport, Inc. ("ACT"), formerly known as Planned Facilities Corporation, was incorporated in 1984 to provide services and consulting in the fields of corrections and mental health, including management, design, and construction of specialized facilities, property ownership, and interstate and intrastate extradition and transportation of prisoners. In 1985, Extradition Corporation of America ("ECA") was formed to engage in the business of interstate transportation of prisoners.

On April 1, 1987, ACT acquired all of the stock in ECA for $475,000. Between 1987 and 1996, ACT asserts, it invested a total of $2,557,000 in ECA through the original investment of $475,000 to purchase ECA's stock, plus cash advances to finance ECA's operating losses and the direct payment of ECA's expenses.[1]

After ACT's acquisition of ECA's stock in 1987, ECA was not profitable. In 1990, ECA ceased operations, and ACT decided to license out ECA's assets. Accordingly, on August 1, 1990, ACT executed a licensing agreement with TransCor America ("TransCor"). Though ECA was not mentioned by name in the licensing agreement, the agreement indicates that ACT licensed to TransCor ECA's prisoner transportation operations and as well as its operating assets, "including trade secrets, know-how, computer programs, operating standards for prisoner transportation, operating data, customer lists, credit information, correspondence, employee records, goodwill, telephone numbers and all rights to perform prisoner transportation and receive the proceeds therefrom on any contracts presently in force between any of ACT's wholly owned subsidiaries and various governmental agencies." In return, ACT would receive four percent of the gross revenues obtained from TransCor's extradition business. The licensing agreement does not reflect that subsidiary ECA would receive any consideration for the licensing of its assets.

In 1994, ACT owned approximately 385,000 shares, or 17%, of TransCor stock.[2] In December 1994, TransCor engaged in a stock-for-stock exchange with Corrections Corporation of America ("CCA"), referred to herein as the 1994 CCA sale. In the 1994 CCA sale, TransCor and CCA entered into a sales agreement, under which the shareholders in TransCor, including ACT, transferred their TransCor stock to CCA in exchange for CCA stock. The CCA stock was worth millions of dollars. Attached to the 1994 CCA sale agreement was a separate escrow agreement, providing that 10% of the CCA shares would be held in an escrow account for a period of one to two years for the payment of claims against CCA. As part of the 1994 CCA sale, ACT and TransCor agreed to terminate the 1990 licensing agreement, in which ACT licensed to TransCor ECA's

[1]No additional capital was paid into ECA. ACT contends instead that it financed ECA's operations through a series of advances to cover ECA's operating losses, and paid some of ECA's debts directly on behalf of ECA.

[2]It is unclear from the record when ACT acquired the TransCor stock.

operating assets; instead, ACT transferred to CCA all of ECA's operating assets.[3] ACT also gave CCA the sole right to use the names "Extradition Corporation of America" and "American Corrections Transport, Inc." In exchange, ACT received CCA stock. In addition, as part of the 1994 CCA sale, ECA entered into an agreement not to compete with TransCor for five years. The documentation of the 1994 CCA sale does not reflect that ECA received any consideration for the transfer of its assets or for the noncompete agreement.

As a wholly-owned subsidiary of ACT, ECA was considered part of ACT's "affiliated group" for federal income tax purposes. This meant that ACT could file a consolidated federal income tax return, which permitted ACT to offset its taxable income by the losses incurred by ECA or another business in the affiliated group. In exchange for this consolidated loss utilization, under federal law, ACT was required to reduce its basis in the ECA stock in amounts equal to the ECA losses which were utilized by ACT for federal tax purposes.

In contrast, under Tennessee law, the "separate entity" rules are applied for Tennessee Franchise & Excise ("F & E") tax purposes, under which consolidated F & E tax returns are not permitted. Consequently, under Tennessee law, ACT and ECA were required to file separate F & E tax returns, and ACT could not use ECA's operating losses to reduce its taxable income in calculating its Tennessee F & E tax liability. The taxpayer's taxable income for F & E purposes, referred to as "net earnings" in the Tennessee statutes, is the taxpayer's federal taxable income, before the operating loss deduction, subject to adjustments defined in Tennessee Code Annotated § 67-4-805(b). ***See*** Tenn. Code Ann. § 67-4-805(a) (1998).

After the 1994 CCA sale, ECA filed annual corporate reports with the Tennessee Secretary of State in 1995, 1996, 1997, and 1998. ECA also filed Tennessee state F & E tax returns for the tax years 1989 through 1997. The state F & E tax returns for ECA from 1990 through 1996 reflect no business activity and state no book value for the assets of the company. The balance sheet portions of those state tax returns were typically marked "dormant corp." or "reference federal return attached." In 1995 and 1996, ECA filed separate federal returns, showing that ECA had 1000 shares of stock outstanding with a value of $1,000, and "other assets" worth $1,000. On all of ACT's consolidated federal returns filed after 1990, a notation is attached stating that "[a]ll revenues, expenses and net income was [sic] generated by [ACT]. In addition, the subsidiary [ECA] has no assets, or liabilities. Therefore, no detail of financial statements have been prepared showing activities or balances of the subsidiary companies."

The ECA stock was never sold by ACT. ACT filed articles of dissolution with the Tennessee Secretary of State on October 2, 1997. ECA was dissolved on September 21, 1998.

The subject of this appeal is a deduction claimed on ACT's 1996 state F & E tax return. As background, by 1996, according to the 1996 consolidated federal income tax return of ACT's

[3]The record indicates that ECA had no tangible assets at that time, and that ECA transferred only intangible assets to CCA.

affiliated group, ACT and its affiliates had a consolidated operating loss carryover of $2,108,089, which is comprised of accumulated operating losses over the prior seven years that had not yet been applied to offset income. In 1996, ACT sold some of its CCA stock, generating a capital gain of $3,178,967. To offset this, ACT properly applied the entire $2,108,089 in consolidated operating loss against its income on the 1996 consolidated federal tax return, making its total taxable income $248,099.

On the 1996 Tennessee state F & E tax return initially filed by ACT, ACT also sought to claim the loss carryover deduction of $2,108,089, which made its taxable income on that return $263,099.[4] Sometime thereafter, however, the Tennessee Department of Revenue informed ACT that it could not use the carryover operating loss deduction in that manner on the state F & E tax return because of Tennessee's "separate entity" rules. In response, in March 1998, ACT filed an amended 1996 Tennessee F & E tax return, claiming a *capital* loss, rather than an *operating* loss. The capital loss was claimed pursuant to Tennessee Code Annotated § 67-4-805(b)(2)(D), which provides that, for F & E tax purposes:

> [(b)](2) There shall be subtracted from the federal taxable income:
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> * * *
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> (D) A portion of the gain or loss of the sale or other disposition of property having a higher basis for Tennessee excise tax purposes than federal income tax purposes measured by the difference in the Tennessee basis and the federal basis . . . .

Tenn. Code Ann. § 67-4-805(b)(2)(D) (1998). Thus, if the basis in property for Tennessee excise tax purposes ("state basis") is greater than the basis for federal income tax purposes ("federal basis"), the gain or loss by the sale or "other disposition" of the property is measured by the difference between the state basis and the federal basis. Under this "basis differential" deduction, ACT claimed that its federal basis in the ECA stock was zero, because all the losses in ECA had been applied against income, and that its state basis in the ECA stock had remained unchanged. The difference between the two was claimed as a deduction by ACT on Schedule J of ACT's amended 1996 Tennessee F & E tax return, which stated that ACT had sustained a "[p]ortion of capital loss not included in federal taxable income" in the amount of $1,923,890. That capital loss, combined with ACT's own operating loss carryover of $184,199, gave ACT the same $2,108,089 deduction as was claimed on the F & E tax return initially filed by ACT, and therefore resulted in the same taxable income of $263,099.

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[4]This amount is equal to the federal taxable income plus $15,000 in estimated payments deducted on the consolidated federal form. Essentially, then, ACT reported the same taxable income on its 1996 federal return as on its 1996 F & E return.

On May 16, 1998, the Commissioner sent ACT a letter and a Notice of Assessment ("Notice") for $129,101.75 ($112,271 in tax liability and $16,830.75 in interest),[5] disallowing the 1996 capital loss deduction. In addition, the Commissioner assessed against ACT $3,817.52 for unpaid estimated F & E taxes for 1997.[6] In response, on June 26, 1998, ACT sent the Commissioner an informal conference statement, arguing that its claim of ECA's operating loss carryover on its 1996 F & E return was proper. ACT asserted that "CCA . . . acquired the stock of ECA from ACT at no additional cost, with the intention that ECA would be liquidated by CCA" in the 1994 CCA sale. This was later corrected in a letter dated July 31, 1998, in which ACT stated that "it has just come to our attention that [ACT] still currently owns all the stock of [ECA]." ACT then maintained that the 1996 deduction was based on the write-off of worthless ECA stock, thereby generating a capital loss to ACT.

In an attempt to resolve the disputed deduction, ACT participated in an informal taxpayer conference with a Tennessee Department of Revenue administrative hearing officer. Subsequently, on October 27, 1998, the Department of Revenue administrative hearing officer sent a letter to ACT upholding the assessment. The hearing officer concluded that, "[a]lthough the Taxpayer asserts that the zero basis is the federal basis and not the Tennessee basis in the stock, I find no legal authority which supports the proposition that there should be a different basis in the stock for federal or Tennessee purposes under these facts." The hearing officer expressed concern over ACT's "recharacterization" of the deduction from an operating loss of a subsidiary to a capital loss from the disposition of stock, stating:

> I am concerned about the Taxpayer's recharacterization of the deduction from the net operating loss of a subsidiary to capital loss from the sale of stock to a write-off of worthless stock. I am also concerned that the Taxpayer appears to have used a purchase method of accounting to record the purchase of ECA, whereby the fair market value of ECA's assets are recorded on ACT's books and records. But then when trying to take the write-off of the stock as worthless, Taxpayer asserts that it used the equity method of accounting, whereby it would have recorded the investment in accounting methods and the numerous changes in the Taxpayer's reasons for the adjustment weigh against the validity of its position.

The hearing officer ultimately concluded that ACT "has failed to present clear and convincing evidence to show that it is entitled to take the deduction sought in this case." ACT paid the assessment under protest.

On December 8, 1998, ACT filed the lawsuit in the trial court below pursuant to Tennessee Code Annotated § 67-1-1801, seeking a refund of the paid tax assessment. ACT alleged that the

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[5] The Commissioner's records showed that ACT had a separate operating loss carryover of $236,896, but had only utilized $184,199 of those losses on the 1996 F & E return, leaving a $52,697 unused carryover loss. Therefore, from the $1,923,890 deduction that was disallowed, the Commissioner subtracted $52,697, then multiplied the difference ($1,871,193) by the 6% excise tax rate to arrive at her assessment of $112,271.

[6] ACT challenges the 1997 assessment only insofar as it is affected by the 1996 assessment. The Commissioner agrees that the propriety of the 1997 assessment depends on the propriety of the 1996 assessment. Therefore, we need not address separately the propriety of the Commissioner's assessment related to the 1997 tax year.

Commissioner's assessment was incorrect and contrary to Tennessee Code Annotated § 67-4-805(b)(2)(D). The parties filed cross-motions for summary judgment, which were denied by the trial court in an order dated May 31, 2001.

A bench trial was held on July 9, 10, and 11, 2001. ACT submitted the testimony of several witnesses. Mike Shmerling ("Schmerling"), the founder of ACT and a Certified Public Accountant ("CPA"), testified regarding ACT's acquisition of ECA and ECA's losses in its early years. Though no primary accounting documents were submitted, Shmerling explained that by the end of 1996, ACT had invested a total of $2,557,000 in ECA, and that the total loss in ECA was approximately $2,108,089, the amount of the 1996 loss carryover. The difference between the investment and the total loss, he explained, was due to the loss utilization ACT used in the earlier years. Shmerling was questioned about the licensing agreement between ACT and TransCor under which TransCor paid ACT a licensing fee for the use of ECA's operating assets. He acknowledged that ACT received income of about $800,000 in royalties under the agreement, and said that this income was used to pay old debts of ECA, such as interest on loans, legal fees and the like. He testified that ECA's stock became worthless and was abandoned in 1996, because in that year the restrictions under the escrow agreement in the 1994 CCA sale (the agreement that 10% of CCA shares would be held in escrow for one to two years) had closed, and the remainder of the CCA stock was distributed. At that point, Schmerling testified, ECA was worthless, and the ACT board of directors surrendered the ECA stock to ACT's attorneys to handle "in the course of winding down the business." Schmerling was questioned about why ECA's 1996 federal tax return reflected that ECA had $1,000 in "other assets" and capital. Shmerling explained that he had mistakenly thought that the federal government had a minimum capital requirement of $1,000, and so he simply put on the federal return that ECA had $1,000 in assets and capital. Despite the representation on the federal return, Schmerling said, ECA was worthless at that time.

ACT also proffered the testimony of three expert witnesses. The first was Mary Ann Brown ("Brown"), a CPA. Brown testified that she had reviewed all the tax returns filed by ACT and ECA, and concluded from this review that when the ECA stock became worthless, ACT was entitled to write it off and claim the basis differential deduction on its 1996 F & E tax return. In Brown's opinion, the appropriate year for the write off was 1996, because that was the year that ACT's obligations under the 1994 CCA sale would end, and the rest of the CCA stock would be distributed.

ACT also submitted the testimony of the CPA who prepared the tax returns for ACT in 1996 and 1997, Harvey Hoskins ("Hoskins"). Hoskins said that the amount claimed by ACT as a capital deduction on its 1996 F & E tax return ($1,923,089) represented the reduction in ACT's federal basis in the ECA stock. He asserted that ECA was worthless at that time, and that, therefore, ACT was entitled to the entire deduction in 1996 because that was the first year in which ACT recognized revenue against which it could utilize its operating loss carryover. Finally, ACT submitted the testimony of another CPA, Christopher Lovin, who testified about when a disposition occurs for purposes of reporting a gain or loss on that property. Lovin acknowledged that he was not aware of an instance in which worthlessness or abandonment of a stock was treated as a "disposition" of that asset. Nevertheless, he opined that the primary factor in determining whether it was an "other disposition" under Tennessee Code Annotated § 67-4-805(b)(2)(D) would be whether the taxpayer had relinquished all of its rights in the given property.

The Commissioner called one witness, Terri McAllister ("McAllister"), as an expert in the field of Tennessee franchise and excise tax returns. Though not a CPA, McAllister had been a tax auditor for the Tennessee Department of Revenue for over thirteen years. McAllister disagreed with Brown's assertion that ACT's deduction was proper. McAllister said that the F & E return initially filed by ACT, claiming the $2.1 million loss carryover deduction on the consolidated federal income tax return, was improper because ACT's records did not reflect that ACT had a separate net operating loss carryover of $2.1 million. The amended return subsequently filed by ACT was also improper, McAllister asserted, because ACT claimed a deduction for a capital loss, but included no supporting documents to show what generated that capital loss. McAllister explained that, ordinarily, when a company computes a capital loss, there is a federal form Schedule D or some other computation in the tax return showing the calculation of the cost basis and the book value of the asset, and then the corresponding gain or loss from the disposition of the asset. In this case, McAllister testified, there were no such computations on ACT's tax return or anywhere else. McAllister further testified that she did not believe that ECA was worthless in 1996, because the corresponding federal income tax returns for ECA listed "other assets" of the company of $1,000 and $1,000 in capital stock.

At the conclusion of the trial, the trial court asked both parties to each submit proposed findings of fact and conclusions of law. Both parties did so. On November 6, 2001, the trial court entered an order finding in favor of the Commissioner and adopting her proposed findings. On May 21, 2002, the trial court entered a final order incorporating the Commissioner's proposed findings of fact and conclusions of law. In that order, the trial court held that ACT failed to show by clear and convincing evidence that its ECA stock had a different basis for state F & E tax purposes and federal income tax purposes. The trial court further found that ACT had failed to prove its investment in ECA, or that ECA suffered the losses in the amount claimed. In reaching that conclusion, the trial court noted that ACT produced no original primary documents, such as book entries or canceled checks, to support its claim. In addition, the trial court held that "ACT did not demonstrate, by clear and convincing evidence, that it disposed of its ECA stock prior to 1998." In its conclusions of law, the trial court held that the worthlessness of a stock does not constitute an "other disposition" for purposes of Tennessee Code Annotated § 67-4-805(b)(2)(D). In the alternative, the trial court determined that, even if the worthlessness of stock could be considered an "other disposition," ACT did not demonstrate by clear and convincing evidence that its ECA stock became worthless in 1996, as opposed to a later or earlier year. ***See James v. Huddleston***, 795 S.W.2d at 661, 663 (Tenn. 1990) (noting rule that taxpayer must prove that the assessment is incorrect by clear and convincing evidence).

On appeal, ACT takes the same position as it did in the trial court. First, ACT argues that, when a property becomes worthless or abandoned by an identifiable event, that event constitutes an "other disposition" for purposes of Tennessee Code Annotated § 67-4-805(b)(2)(D). ACT contends that it made an "other disposition" of its ECA stock when the stock became worthless and was abandoned in 1996. ACT claims that 1996 is the operative year because that was the year in which the CCA sale was finally concluded by virtue of the closing of the escrow agreement in which the remaining CCA stock was held and the final distribution of the CCA shares were conveyed under the 1994 CCA sale agreement. Therefore, ACT maintains, it is entitled to a deduction pursuant to section 67-4-805(b)(2)(D) in an amount equal to the difference between its federal basis and its state basis in its ECA stock. ACT argues the evidence at trial showed that its federal basis in the ECA stock was reduced to zero in 1996 when it utilized the entire operating loss carryover deduction attributable to the operating losses of ECA on its federal income tax return. At that point, ACT argues, it was entitled to deduct the entire amount of its state basis in ECA on its state F & E tax return.

In response, the Commissioner argues that the "sale or other disposition" to which the state deduction in section 67-4-805(b)(2)(D) applies does not include a property becoming worthless or abandoned. Rather, the Commissioner asserts, "other disposition" means something akin to a sale, such as a gift or a liquidation. Nevertheless, even if the worthlessness or abandonment of a stock is considered a "disposition," the Commissioner argues, neither of those events took place in 1996 in this case. In the alternative, the Commissioner maintains that, even if ACT is found to have made an "other disposition" of the ECA stock in 1996, it would not be entitled to the deduction under section 67-4-805(b)(2)(D), because it did not submit clear and convincing evidence of the difference between the state and federal bases in the stock.

On appeal, the trial court's findings of fact are reviewed *de novo*, with a presumption of correctness, unless the preponderance of the evidence is otherwise.[7] ***See L.M. Berry & Co. v. Huddleston***, No. 01A01-9809-CH-00487, 1999 WL 976528, at *4 (Tenn. Ct. App. Oct. 28, 1999). Questions of law are reviewed *de novo*, with no presumption of correctness. ***See Associated P'ship I, Inc. v. Huddleston***, 889 S.W.2d 190, 194 (Tenn. 1994). An issue of statutory interpretation is considered to be a question of law, subject to *de novo* review. ***Wilkins v. Kellogg Co.***, 48 S.W.3d 148, 151 (Tenn. 2001).

In its first issue on appeal, ACT presents a pure question of law, namely whether a stock becoming worthless or abandoned is an "other disposition" of that stock within the meaning of Tennessee Code Annotated § 67-4-805(b)(2)(D). In interpreting a statute, the role of the court is to "ascertain and give effect to the legislative intent." ***Sharp v. Richardson***, 937 S.W.2d 846, 850 (Tenn. 1996). Unless the statute is ambiguous, legislative intent is derived from the face of the

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[7] ACT argues that the trial court violated Tennessee Rule of Civil Procedure 52 by adopting verbatim the proposed findings of fact and conclusions of law submitted by the Commissioner without critical analysis or comment. As the Commissioner notes, however, "it is permissible and indeed sometimes desirable for the trial court to permit counsel for any party to submit proposed findings and conclusions." ***See Delevan-Delta Corp. v. Roberts***, 611 S.W.2d 51, 53 (Tenn. 1981). The trial court's factual findings, even when they result from the adoption of a party's proposed findings, are reviewed in light of the record on appeal, presuming the trial court's factual findings to be correct unless the evidence preponderates otherwise. ***See, e.g., Fulcher v. Allen***, 2 S.W.3d 207, 214 (Tenn. Ct. App. 1999); Tenn. R. App. P. 13(d).

statute, and the court may not depart from the "natural and ordinary" meaning of the language used in it. ***Davis v. Reagan***, 951 S.W.2d 766, 768 (Tenn. 1997).

The plain language of Tennessee Code Annotated § 67-4-805(b)(2)(D) requires a "sale or other disposition of property" in order to deduct from the taxpayer's taxable income the amount of the loss, i.e., the difference between the state and federal bases in the property. Neither party cites any Tennessee caselaw regarding what constitutes an "other disposition" under the statute. Consequently, ACT relies on federal law and cases from other jurisdictions holding that the event of a stock becoming worthless can constitute a "disposition" for purposes of recognizing gain or loss. ***See, e.g., White v. Comm'r***, 1970 WL (U.S. Tax Ct.) 1610 (U.S. Tax Ct. May 28, 1970); ***First Nat'l Bank of Minneapolis v. United States***, 58 F. Supp. 425 (D. Minn. 1944); ***Edward Hines Lumbar Co. v. Galloway***, 154 P.2d 539 (Or. 1944). ACT argues that a stock becomes worthless when the stock has no book value and an identifiable event occurs whereby there is no reasonable expectation that the stock may acquire value in the future through foreseeable operations of the corporation. ***See White***, 1970 WL (U.S. Tax Ct.) 1610 (no page numbers available). In addition, ACT argues that the abandonment or voluntary surrender of a stock for no consideration also constitutes a "disposition" for purposes of recognition of gain or loss. ***See Comm'r v. Fink***, 483 U.S. 89, 98-99 (1987). ACT states that it voluntarily surrendered its ECA stock to its corporate counsel in 1996 for no consideration. Therefore, at that time, ACT argues, it disposed of the stock by abandonment within the meaning of the statute.

In contrast, the Commissioner contends that the definition of "other disposition" must have a meaning similar to that of the word "sale." The Commissioner claims that the doctrine of *ejusdem generis*[8] applies in this case, meaning that where general words follows a special word that limits the scope of the statute, the general words will be construed as applying to things of the same kind or class as those indicated by the preceding special word. ***See Lyons v. Rasar***, 872 S.W.2d 895, 897 (Tenn. 1994); BLACK'S LAW DICTIONARY 535 (7th ed. 1999). In other words, "other disposition" should be construed to mean something similar to the "sale" of property, such as trading the property or giving it to someone else. ***See Walsh v. Division of Taxation***, 15 N.J. Tax 180, 183 (1995) (holding that a write-off of a non-business bad debt was not a disposition of property under New Jersey law based on the doctrine of *ejusdem generis*). One cannot dispose of property, the Commissioner contends, by simply holding on to the property as it becomes less valuable over time. Rather, the "disposition" of property means taking active steps that result in the taxpayer no longer possessing the property at issue. She maintains that the stock in ECA was not disposed of by ACT; it simply devalued. The Commissioner argues that ACT took no clear action to relinquish control in the stock in order to claim a "disposition" for purposes of realizing a gain or loss on the stock.

Assuming, without deciding, that the event of a stock becoming worthless or abandoned can be considered an "other disposition" under Tennessee Code Annotated § 67-4-805(b)(2)(D), we examine the trial court's conclusion that ACT had not demonstrated that the ECA stock it held became worthless or was abandoned in the tax year 1996, as opposed to a later or earlier year.

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[8] Literally translated, this Latin phrase means "of the same kind or class." BLACK'S LAW DICTIONARY 535 (7th ed. 1999).

ACT contends that it proved that its ECA stock became worthless for purposes of "disposition" in 1996. ACT reasons that a stock becomes worthless when two things occur contemporaneously: when the stock has no book value, and when an identifiable event occurs whereby there is no reasonable expectation that the stock will ever acquire value through foreseeable operations of the corporation. ACT argues that 1996 was the first year in which both of these requirements were satisfied. First, ACT claims, in 1996, ECA had no book value. Second, 1996 was the year in which the escrow account established in the 1994 CCA sale was closed and the remaining shares of CCA stock were distributed. At that point, ACT argues, the closing of the escrow account and the ACT board's decision that ECA would never again be operational constituted identifiable events whereby there ceased to be any reasonable expectation that the ECA stock would acquire value through foreseeable future operations.

In the caselaw cited by ACT holding that the worthlessness of stock can be considered a "disposition" in order for stock to become worthless in a certain year, there must be an identifiable event in that year to show that the worthlessness actually occurred in that year, as opposed to a previous or later year. As held in ***White***, a stock is considered worthless when there is no reasonable hope of potential value: "The loss of potential value, if it exists, can be established ordinarily with satisfaction only by some 'identifiable event' in the corporation's life which puts an end to such hope and expectation." ***White***, 1970 WL (U.S. Tax Ct.) 1610; ***see Morton v. Comm'r***, 38 B.T.A. 1270, 1278-79 (1938), ***aff'd*** 112 F.2d 320 (7th Cir. 1940). Examples of such "identifiable events," the court reasoned, are "bankruptcy, *cessation from doing business*, or liquidation of the corporation, or the appointment of a receiver for it." ***White***, 1970 WL (U.S. Tax Ct.) 1610 (emphasis added).

ACT claims that this identifiable event occurred in 1996, because that is the year in which the 1994 CCA sale became irrevocable through the closing of the escrow account and, therefore, ECA's contractual obligations in the 1994 CCA sale were met at that time. ACT relies on the expert testimony of Mary Ann Brown, who admitted that she had not, in fact, read the escrow agreement. A review of the transaction belies ACT's assertion. In the 1994 transaction, ECA's operating assets, instead of being licensed to TransCor, were transferred from ACT to CCA. CCA was also given the sole right to use ECA's name. TransCor stock was to be exchanged for CCA stock. All of this occurred in 1994, not 1996. As part of the 1994 transaction, a separate escrow agreement was entered into, whereby 10% of the CCA stock was set aside in an escrow account for one to two years to be available to fund any claims filed against CCA, some general and some specific. ECA, as a separate entity, was not even a party to the 1994 CCA sale or the escrow agreement. ECA's only contractual obligation in that stock exchange arose out of a covenant not to compete with CCA, which was to last five years in duration. Therefore, if ECA is bound by any contractual obligation after 1994, that obligation lasted until 1999. Moreover, the escrow agreement contained no mechanism for ECA's assets or name to be transferred back or for the transfer of assets to be "revoked"; the expiration of the escrow agreement meant only that CCA stock was no longer set aside to fund claims.

More directly, Schmerling's own testimony shows that, from 1990 forward, ACT had no reasonable expectation that the ECA stock would acquire value through foreseeable future operations. Shmerling testified that ECA conducted no business after ACT licensed away its assets to TransCor in 1990, and that ECA had no assets or liabilities after that time. Schmerling said that ECA had been losing money for three years, and ACT licensed away the assets to cut its losses. When asked whether ECA had any "potential for future value" in 1993, during the licensing agreement, Shmerling said simply, "No." The record contains no indication that ECA was ever expected to resume operations after that point. Although ECA's 1995 and 1996 federal tax returns showed that ECA had $1,000 in "other assets", Shmerling explained that this was merely an accounting entry made in an attempt to comply with an unidentified federal regulation. Even if ECA had value, or there was a glimmer of a reasonable expectation of future value, during the course of the licensing agreement, any such value or expectation of value ended when the parties executed the 1994 CCA sale agreement. Indeed, ACT's original position with the Commissioner reflects its mistaken presumption that the ECA shares had been sold as part of the 1994 CCA stock exchange. Thus, the record demonstrates that the cessation of any reasonable expectation of future value for ECA occurred well before 1996. The expiration of the escrow agreement clearly would not constitute an "identifiable event" showing that the ECA stock became worthless in that year. ***See Carlins v. Comm'r of Revenue***, 1988 WL (U.S.Tax Ct.) 13212 (U.S. Tax Ct. Feb. 25, 1988) (holding that stock is worthless when it has no potential value). For these reasons, even if a property becoming worthless can constitute a "disposition" of that property under section 67-4-805(b)(2)(D), clearly ECA's stock became worthless, if at all, in a year other than 1996.

ACT also argues that its abandonment of the ECA stock would constitute an "other disposition" for purposes of section 67-4-805(b)(2)(D).[9] ACT claims that it abandoned the ECA stock in 1996 when it surrendered the stock certificate to its lawyers to handle the "winding down" of the business. ACT cites no authority to support its contention that disavowing the stock and handing it over to corporate counsel constitutes legal abandonment of that property. The undisputed evidence shows that ACT remained the sole shareholder in ECA stock at least until ACT's dissolution in 1997. ECA itself was not dissolved until 1998. ACT's 1996 federal income tax return included no indication that it intended to dispose of the ECA stock by abandonment or otherwise. In fact, ACT's 1997 federal return shows that the company still owned all of ECA's stock. Thus, assuming, without deciding, that the abandonment of stock can constitute an "other disposition" for purposes of the Tennessee Code Annotated § 67-4-805(b)(2)(D), ACT's conduct falls short of a clear abandonment.

We now address the trial court's additional basis for rejecting ACT's claim. The trial court determined that ACT submitted insufficient evidence to establish the amount of its investment in ECA and the amount of the losses attributable to ECA. Consequently, the trial court concluded that "ACT has failed to show, by clear and convincing evidence, that ECA ever had a different basis for state excise tax purposes than for federal income tax purposes." Thus, under that holding, even if

[9]"Abandonment" of a stock is typically discussed in the bankruptcy context when a bankruptcy trustee chooses to abandon a stock that is burdensome to the estate under 11 U.S.C. § 554. In such cases, it must be shown that there is an unequivocal intent to abandon the property. ***See, e.g., In re Heil***, 141 B.R. 112, 115 (Bankr. N.D. Tex. 1992). Outside the bankruptcy arena, however, there is very little authority on what constitutes "abandonment" of a stock for purposes of reporting a gain or loss from the disposition of that property on a tax return.

there was a "disposition" of the ECA stock in 1996, ACT did not prove by clear and convincing evidence the amount of the deduction to which it was entitled, i.e., the difference between its federal and state bases in the ECA stock.

ACT argues that the evidence submitted at trial established the amount of its investments in and losses from the operation of ECA. Regarding its investments, ACT claims that the testimony of its witnesses showed that ACT had invested over $2.5 million in ECA. Shmerling testified that ACT paid $475,000 initially for the ECA stock. Subsequently, he said, ACT obtained loans to make cash advances to the company, and it also paid some of ECA's expenses directly.[10] Schmerling contended that ACT made loans to ECA which ECA did not have the income to repay. Schmerling asserted that approximately 90% of the $2,108,089 consolidated net operating loss on ACT's 1996 federal return was attributable to ECA's losses, though no financial documents were submitted into evidence to support his assertion. Hoskins, who prepared ACT's 1996 returns, determined that $1,923,890 should be deducted on ACT's 1996 F & E return because that amount was ACT's consolidated net operating loss carryover amount ($2,108,089) less the amount of ACT's separate net operating loss of ($184,199). According to ACT, the difference represents the amount of the ECA net operating loss that ACT used to offset income on its consolidated1996 federal return. Because ACT utilized the remainder of ECA's operating loss carryover for federal tax purposes, ACT's federal basis in the ECA stock was reduced at least by that amount. ACT's state basis was not reduced, ACT argues, and so its basis for state tax purposes remained at $1,923,890 or higher. ACT maintains that permitting it to take this deduction is consistent with the purpose of section 67-4-805(b)(2)(D), which is to remedy the unfairness caused by exposing taxpayers to greater state tax liability because of federal consolidated loss utilization rules. ***See South Cent. Bell Tel. Co. v. Celauro***, 754 S.W.2d 605, 608 (Tenn. 1988).

In response, the Commissioner argues that ACT failed to provide sufficient documentation regarding the amount of its basis in the ECA stock in order to grant it the deduction under section 67-4-805(b)(2)(D). In order to prove the basis differential, the Commissioner contends, ACT must show (1) the amount of money that it invested in ECA, thus establishing the amount of the state and federal bases for the stock; (2) how the federal basis in the ECA stock was affected over time by additional investments or gains that could increase the basis or losses that would lower the basis, since the parties agree that the basis for state tax purposes would not have been reduced; and (3) that the ECA stock became worthless in 1996. The Commissioner argues that the evidence of the amount of ACT's investment in ECA is unclear, because some of the contributions to ECA were made from proceeds of loans made to ACT for a combination of business purposes, some unrelated to ECA. The amount of ECA's gains and losses over the years is also unclear, the Commissioner argues, because the returns filed by ACT and ECA lack "single entity" information. For example, on ACT's 1989 consolidated federal tax return filed for ACT's "affiliated group" that included ECA and other entities, the ECA stock is not listed on ACT's balance sheet as an asset, which amount would reflect

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[10]Exhibit 31contains a chart to illustrate the investments of ACT in ECA for each year beginning in April 1987 and ending in December 1996. The total investments, according to the chart, equal $2,557,000. Many of the amounts on that chart, however, are not supported by evidence in the record other than Shmerling's testimony.

the amount of ACT's basis in that asset. Thus, the Commissioner argues, there was no way to determine the amount of ACT's basis in the ECA stock. As another example of conflicting information reported by ACT, the Commissioner notes that, for the tax years 1991-1995, ECA filed state F & E tax returns that showed no assets or liabilities, yet ACT claims that it made investments in ECA of $38,000, $49,000, $27,000, $12,000, and $45,000 respectively in those years by directly paying ECA's debts. Such investments would have resulted in a corresponding increase in ACT's federal basis in the ECA stock, "closing the gap" between the federal basis and the state basis.

The issue of whether the evidence is sufficient to show the amount of the difference in ACT's bases in the ECA stock for state and federal tax purposes is a question of fact. Therefore, we must review the issue *de novo* on the record, presuming the trial court's decision to be correct unless the evidence preponderates otherwise. We are mindful that a tax assessment made by the Commissioner of Revenue "shall be presumed accurate unless records are submitted evidencing otherwise." Tenn. Code Ann. § 67-1-1438(a) (1998). We also note that the burden is on ACT to show by clear and convincing evidence that the tax assessment against it was incorrect. ***James v. Huddleston***, 795 S.W.2d 661, 663 (Tenn. 1990).

The record in this case contains evidence to show that ACT invested large sums of money in ECA. However, the evidence also showed that ACT's basis in the ECA stock may have fluctuated over time, and there is no way to determine from the record the amount of that fluctuation, in part because ACT failed to keep any "separate entity" records for ECA after the 1990 licensing agreement. Shmerling stated in his deposition that he did not know whether ACT and ECA maintained separate bank accounts, stating that "it's expensive to maintain a bank account." He asserted that "ACT paid bills on behalf of ECA through 1996." Between 1991 and 1995, ACT claimed to have invested $171,000 in ECA by directly paying ECA's debts. Despite all of this, ECA's post-1990 tax returns reflected that ECA had no debts during that time. Furthermore, ACT proffered no evidence showing whether those payments were made for debts of ECA, ACT, or some other business in the affiliated group. Moreover, it is undisputed that ACT licensed out ECA's assets between 1990 and 1994. Nevertheless, ACT attributed no income to ECA from the licensing of ECA's assets. The Commissioner's expert at trial testified that, whenever ECA's assets were licensed, transferred or sold, some consideration must have been given, and that consideration must be taken into account when determining ACT's basis. At oral argument, the Commissioner explained that "ACT can't recognize all that income and put it in its back pocket without running it through ECA. ECA is making some money, we think, but we don't know – which would increase the federal basis, which would close the gap. But we don't know."

The lack of documentary evidence supporting the claimed basis differential is made apparent by the testimony of CPA Hoskins, who prepared ACT's 1996 F & E returns. When asked how he determined the amount of the claimed basis differential ($1,923,890), Hoskins explained:

> Question: What does [Schedule U on ACT's amended 1996 F & E return] represent?
>
> * * *
>
> [Hoskins]: Schedule U, that is the accumulation of [ACT's] prior net operating losses for the state — Department of Revenue losses claimed in prior periods or losses carried over.
>
> Question: And that's what adds to your 184,199?
>
> [Hoskins]: That's correct.
>
> Question: So it is fair to say that you subtracted that number from the [$2,108,089] to come up with the [$1,923,890]?
>
> [Hoskins]: Exactly.

Thus, Hoskins admittedly backed in the $1,923,089 amount to allow ACT to have a deduction equal to its 1996 consolidated loss carryover ($2,108,089).[14] Hoskins' notation on the amended F & E tax return explained, "The return is amended to reflect the previously shown net operating loss carryover as a capital loss . . . . The federal tax return reflects the consolidated net operating loss carryover. The amended return results in no change in the tax liability as shown on the original return." Hoskins asserted that the issue was not whether ACT was entitled to a deduction, but "how it should be reflected on the tax returns." From that explanation, it is clear that Hoskins did not arrive at ACT's capital loss deduction by engaging in an analysis of ACT's investments and ECA's income. None of the experts who testified at trial justified $1,923,089 as the appropriate amount of the basis differential. Indeed, CPA Brown admitted that there was no way to tell whether ACT's $2,108,089 loss carryover was attributable to ECA. The Commissioner's expert testified that a capital loss is normally computed by reference to a computation in the tax return involving the cost basis and book value of an asset, and then a corresponding gain or loss from the disposition of that asset. In this case, there was no such computation. Therefore, after a careful review of the testimony, exhibits, and tax records in the appellate record in this case, we must conclude that the trial court did not err in finding that ACT did not submit sufficient evidence to establish that it was entitled to the basis differential deduction of $1,923,890 claimed on its 1996 F & E tax return.

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[14] Hoskins subtracted ACT's separate loss carryover ($184,199) from ACT's consolidated loss carryover ($2,108,089), and believed that the difference would reflect ECA's separate loss carryover, which he considered to be ACT's basis in ECA. Hoskins did not claim that $1,923,890 is the precise amount of the basis differential. ACT states in its brief that "the tax basis for state purposes was $1,923,890 *[or] higher*." (Emphasis added). In other words, ACT did not calculate its state basis in ECA by reviewing its investments and ECA's income. Such a task would be very difficult in light of the fact that there are no separate books for ECA. Rather, ACT clearly determined its claimed state basis in ECA stock by referring to ACT's consolidated loss carryover in 1996.

ACT raises one final issue for our review. ACT argues that, even if the basis differential deduction is not allowed, the trial court erred in failing to correct a mistake in the Commissioner's assessment. In determining the assessment amount, the Commissioner permitted ACT to deduct its separate loss carryover ($184,199) from its taxable income. In calculating that amount by using records from ACT's previous years of operation, however, the Commissioner listed ACT as having $187,686 in *income* in 1990, when in fact ACT had reported a *loss* of $187,686 in that year. The Commissioner readily admits that she erred in using the $187,686 income in calculating the 1996 assessment amount. However, the Commissioner maintains that, the $187,686 loss to which ACT refers was ACT's *consolidated* loss. Because of Tennessee's separate entity rules, ACT's *separate* income or loss should have been used. A breakdown attached to the 1990 federal return showed that ACT actually had income of $295,469. Consequently, if the error were to be corrected properly, the Commissioner argues, ACT's separate income of $295,469 for 1990 would be utilized, not the consolidated loss of $187,686, as argued by ACT. A greater amount of income would result in an even greater assessment against ACT. Therefore, the Commissioner argues, the mistake about which ACT complains was harmless error to ACT.

The trial court made no findings on this issue. From our review of the record, however, we are persuaded that the Commissioner's position on this issue is accurate. ACT's 1990 federal return clearly reflects that ACT had separate income of $295,469 in that year. Therefore, if the Commissioner's mistake were properly corrected, the result would be a decrease in available loss carryover, which would mean an even greater assessment to ACT. Thus, because the plain record shows that the Commissioner's error did not adversely affect ACT, we deem it to be harmless error.

We affirm the decision of the trial court. Costs on appeal are to be taxed to Appellant American Corrections Transport, Inc., and its surety, for which execution may issue, if necessary.

HOLLY M. KIRBY, JUDGE